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AGENDA ITEM 8

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:** CONSENT:
- a. Fixed Income Policy – Revision of Credit Enhancement Program
 - b. Miscellaneous Policy – Revision of Directed Brokerage Arrangement

IV. ANALYSIS:

The Policy Subcommittee met on June 16, 2006 and discussed or acted on the following:

- A. Policy Subcommittee History – As requested at the April 2006 Subcommittee meeting, this agenda item provided a brief overview of the history of the Policy Subcommittee – 1995 to present. Copies of this informational item are available upon request.
- B. Revised Policies – The Subcommittee recommends that the Investment Committee approve the two attached revised policies.

The policies are black-lined versions from the last adopted policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather, it indicates that the term is defined in the glossary.

- **Item 8a – Fixed Income Policy**

Revision of Credit Enhancement Program

The Credit Enhancement Program (CEP) Policy was adopted on February 14, 2005 by the Investment Committee. After over a year of operation, staff is proposing to revise the CEP Policy in order to improve operational flexibility while maintaining the Program's risk profile. The proposed revisions include the removal of the Originator and Servicer requirements and the addition of a partnership requirement. The Partnership and co-investment language will ensure that CalPERS' interests are aligned with other financial partners.

- **Item 8b – Miscellaneous Investment Policy**

Revision of Directed Brokerage Arrangement

Staff brings this policy revision forward to address two issues:

1. To formalize CalPERS' adoption of a narrow definition of directed brokerage.
2. To update and clarify language and align the Policy with current CalPERS practice.

This Policy revision removes the administrative functions from the policy document, acknowledging they belong more appropriately in administrative procedure desk manuals. All administrative controls currently in place will remain in effect.

Language is included that identifies the type of services that do not receive SEC Section 28(e) protection. The section is revised to more clearly state that computer hardware, professional licensing fees and general overhead expenses are not protected by Section 28(e); therefore, they cannot be purchased using commissions recaptured as part of the System's Arrangements.

V. STRATEGIC PLAN:

This item supports Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The results of this item will provide the System with enhanced efficiencies and ability to manage the overall portfolio.

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